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Community Development Finance: A Neo-Market Solution to Social Exclusion?

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Abstract

Financial exclusion is increasingly being recognised as an important aspect of socio-economic inequality where disadvantaged individuals and communities are isolated from mainstream financial services, particularly affordable and readily available credit. In the face of these problems, social policy initiatives have emerged that have travelled under various names: social investment, micro-finance, community finance and community development finance. These initiatives are seen as the basis of a 'new economics' that will create self-sustaining local economies. The government is also promoting community development finance as an aspect of community regeneration with the aim of providing credit to poor communities to stimulate local enterprise and thereby reduce dependency on state support. The same approach is being taken to grant-funded community and voluntary organisations to encourage them into a neo-market approach to the delivery of services. This article explores the phenomenon of community development finance and assesses its proposed role in community regeneration and in relation to the community and voluntary sector.

Introduction

Financial exclusion is increasingly being recognised as an important form of socio-economic inequality (Sinclair, 2001; Kempson and Whyley, 2000; Ford and Rowlingson, 1996). Disadvantaged individuals and communities are finding themselves isolated from mainstream financial services, particularly affordable and readily available credit (Whyley and Brooker, 2004; Collard and Kempson, 2005). In the face of these problems, various social policy initiatives have emerged that have travelled under different names: social investment (Bruyn, 1987; Giddens, 1998; Affleck and Mellor, 2003), micro-finance (Wright, 2000; Honohan, 2004), and community finance or community development finance (Benjamin *et al.*, 2004; CDFA, 2005). One of the best known is Mohammad Yunus's Grameen Bank micro-credit initiative in Bangladesh (Morduch, 1999; Hussain *et al.*, 2001;

Amin *et al.*, 2003). Organisations addressing financial exclusion range from credit unions to community reinvestment and development trusts, providing services from personal finance to enterprise development loans (Fuller and Mellor, 2004). This article is concerned with the latter: social and community finance initiatives that are aimed at solving social disadvantage through community, social and individual enterprise.

Investment finance for socially oriented or socially owned enterprises is not new. The Industrial Common Ownership Fund (ICOF) was formed in 1973 to provide loan finance for co-operatives. One of the first area-based community development finance institutions (CDFIs) was the Aston Reinvestment Trust (ART) established in 1997 (Affleck and Mellor, 2003). Since then many micro-finance and community-based initiatives have emerged in the UK, such as Developing Strathclyde's two-year pilot Social Enterprise Fund in 1999; Street UK's micro-credit scheme in 2000; Portsmouth Area Regeneration Trust (now South Coast Moneyline), offering personal and enterprise finance in 2000; and OneLondon in 2002, offering loans to enterprises rejected by the banks. By the end of 2004, the UK Community Development Finance Association (CDFA) had 57 members, lending from £50 to £500,000 with total capital of £400 million (CDFA, 2005: 3). CDFIs obtain their initial capital from a variety of sources, including banks, public agencies, charities, the European Union and individuals (CDFA, 2005: 34–36), but most aim in the longer term to operate as revolving loan funds.

The CDFA describes its members as sustainable, independent financial institutions that 'operate with a common purpose or mission – to bring about social change and achieve social and economic returns by filling gaps in finance and business support' (CDFA, 2005: 10). In particular, its members aim to 'provide capital and support to enable individuals or organisations to develop and create wealth in disadvantaged communities or under-served markets' (CDFA, 2005: 61). CDFIs are seen by the think-tank organisation – the New Economics Foundation – as part of a new, more socially responsive economics, that through the development of social, community and local enterprise will create and sustain local economies, and therefore local communities (Conaty *et al.*, 1998; Guene and Mayo, 2001). Since coming to power, New Labour has incorporated these ideas into its regeneration policies and supported the development of CDFIs through grants and tax credits to attract investment into the sector.

The emergence of CDFIs and the thrust of government policy can be seen as leading to a more enterprise-based and market-oriented approach to regeneration in three ways. The first is the stimulation of local enterprise through community development finance. The second is the aim of expanding social and community enterprise. The third, and perhaps most contentious, is to encourage the community and voluntary sector to be less reliant on grant-funding by taking loan finance. This article will explore each of these approaches.

Social inclusion, local enterprise and the financial exclusion 'gap'

CDFIs identify a financial exclusion 'gap' whereby individuals, (potentially) viable businesses and social enterprises are unable to access conventional bank finance. Exclusion from bank finance could be caused by living in an area without adequate financial services (Leyshon and Thrift, 1994, 1995, 1996), having a poor credit history (Joseph Rowntree Foundation, 1999; Financial Services Authority, 2000) lacking business experience, having an unconventional company structure such as a charity, a not-for-profit, or a co-operative, or the loan requested is too small to interest a bank. This emphasis on financial exclusion chimes well with the government's definition of socio-economic disadvantage as social exclusion (Giddens, 1998; Levitas, 1998; Byrne, 1999), with its heavy stress on economic exclusion (Cameron and Davoudi, 1998; Hills *et al.*, 2002). While much of the New Labour social inclusion agenda has been directed towards encouraging employment through paid work, there are also strands that encourage self-employment, small businesses and social enterprise within, or directed towards, disadvantaged communities (Korsching and Allen, 2004). Poor communities are seen as lacking enterprise and entrepreneurial cultures, while exhibiting 'too much reliance upon established economic institutions, including the public sector, to produce employment' (Giddens, 1998: 124).

Labour 'Old Left' notions of equality and tax-and-spend redistributive approaches have been rejected as not concerned enough with the creation of wealth (Driver and Martell, 2002), in favour of 'an enterprise culture open to all' (Kelly, 1999: 50). As the then Trade Minister, Stephen Byers, stated, 'wealth creation is now more important than wealth redistribution . . . if we don't create wealth there is no opportunity to provide real hope for the future to many people who are left out at the moment' (BBC News, 3 February 1999). The problems of disadvantaged neighbourhoods are seen as shortages of jobs, local services and enterprise; therefore, it is argued, these communities would receive the greatest social impact from the encouragement of enterprise. This is based on the observation that 'start-up rates in the best performing areas are ten times those of the worst': therefore the government aims 'to raise levels of enterprise across the UK, but particularly in deprived areas, where the barriers to enterprise are greatest' (SBS, 2002: 1).

Government interest in community development finance is based upon the assumption that within disadvantaged communities there is an untapped source of entrepreneurship. With the right amount of support and suitable finance, latent entrepreneurship could be created and/or grown (Social Exclusion Unit, 2000). This was signalled in two reports: the 1999 Policy Action Team 3 (PAT 3) *Enterprise and Social Exclusion*, and the 2000 Social Investment Task Force (SITF) Report *Enterprising Communities: Wealth Beyond Welfare*. The PAT 3 report identified three main obstacles to the growth of enterprise in disadvantaged communities: first, lack of suitable advice and knowledge with not enough accessible,

high-quality business support; second, the 'market failure' of traditional financial services, which meant that not enough capital was available for projects with 'high returns to society'; and third, 'a weak culture of support for enterprise, across the whole range of local and national institutions' (HM Treasury, 1999: 1–2). The Minister's Foreword to the report emphasised the government's enthusiasm for encouraging enterprise within disadvantaged communities:

There is a vital role that enterprise can play in helping to renew our poorest and most marginal communities. It helps to create jobs and stimulate activity in communities where crime and unemployment are high. It helps meet the basic needs of local people, by providing vital services like shops. Perhaps most fundamentally, it helps develop self-confidence and determination in local people and communities – the real drivers of regeneration in the long run. (HM Treasury, 1999)

The report noted a sustained gap between demand from small businesses and the supply of finance from banks and other lenders, such that SMEs in deprived areas were likely to be 'less well capitalised and are less likely to have sufficient collateral against which to mortgage the loan' (HM Treasury, 1999: 63). Women were likely to be particularly disadvantaged. Communication problems might also mean that the right information was not being presented to banks, especially where potential borrowers were from minority ethnic backgrounds. A vicious circle meant that fewer successful SMEs in deprived areas meant less experience of borrowing. Smaller loans might also attract higher interest rates being more costly to monitor and assess, further deterring borrowers.

In the face of the gap in financial services, PAT 3 made clear its market orientation: 'the Government promotes competition, innovation and efficiency in the banking sector to ensure that deprived communities are served to the maximum extent by market means' (HM Treasury, 1999: 72). The problem was the need to 'facilitate access to finance and thus encourage sustainable smaller enterprise in deprived areas' (HM Treasury, 1999: 74). However it was recognised that commercial lenders were not able, or willing, to take account of the social importance of investment:

Commercial lending decisions will not take account of the 'social returns' from the lending – for example the positive externalities of wealth creation; high economic participation; and the fact that the success of enterprise in the form of enterprise growth in deprived areas can spill over between firms, for example in better trained and work-ready local workforces, and mutually reinforcing demand for business support services. This external social benefit will not be fully recognised by commercial lenders. (HM Treasury, 1999: 64)

The report acknowledged that 'in the end market mechanisms will not be enough... the Government should also encourage new initiatives to provide finance for enterprise where justified by the high potential returns to society' (HM Treasury, 1999: 3). The government should therefore take an 'evolutionary and catalytic approach' working with banks, community finance initiatives, and regional bodies (HM Treasury, 1999: 76). A mixture of funding would be used to

support local initiatives, but the key aim was still to encourage the commercial sector to become involved, as it would be 'in the bank's long term interests' (HM Treasury, 1999: 67) to support community-based financial provision. The reference here is to the US community finance sector, where the 1977 Community Reinvestment Act has placed obligations upon banks to provide financial services to disadvantaged areas. The US also provides public sector incentives such as the Community Development Finance Institutions Fund to encourage commercial lenders to support CDFIs (Marshall, 2004).

The report's aim was to use community finance to enable community-based initiatives to become a 'bankable proposition' that would encourage the interest of commercial banks. Loans would be aimed at start-ups, existing enterprises in deprived communities and social enterprises, with the objective of them all eventually borrowing from the mainstream. The financial position of the lender and the borrower would be safeguarded through staged finance, scaling down investment plans, monitoring, using group lending, equipping borrowers with financial skills and having a mixed portfolio of risks. It was suggested that potential investors could receive different interest rates with financial returns diminishing as the social benefits increased. This would give commercial investments the market rate, and philanthropic investments little or no financial return. Capital would be attracted to the community development finance sector through a loan guarantee scheme, a challenge fund and tax relief as potential levers. Another proposition was that CDFIs with mature loan portfolios (potentially low risk, because the borrowers had a history of repaying their loans) could sell them on to banks bringing in new funds to be borrowed. Public subsidy would enable 'community finance initiatives to bridge the gap between commercial rates of return to banks and the price paid by enterprises in deprived areas for their borrowing' (HM Treasury, 1999: 71). This would reward patient capital from social investors receiving sub-market rates for their investments and make this form of investment more attractive.

PAT 3 led to the establishment of the Phoenix Fund in 1999, administered through the DTI's Small Business Service (SBS). The fund aims to encourage entrepreneurship in disadvantaged areas by developing 'self-confidence and determination in local people and communities which are the real drivers of regeneration in the long run' (SBS, 2001). Originally, the Phoenix Fund was worth around £100 million (SBS, 2003), rising to £172 million with the 2002 and 2004 Spending Reviews. It includes a Development Fund to aid around 100 projects supporting enterprise in disadvantaged areas and a Business Volunteer Mentoring Association run through the National Federation of Enterprise Agencies. To support CDFIs there is a Challenge Fund and a Guarantee Fund of around £40 million. The Phoenix Fund, which winds up in 2008, has played a major part in developing the CDFI sector, providing 25.7 per cent of capital funds and 37.9 per cent of revenue funds for CDFA members (CDFA, 2005: 33–36).

Wealth beyond welfare

The Social Investment Task Force's (SITF) report *Enterprising Communities: Wealth Beyond Welfare* can be seen as the community development finance sector's wish list. The Task Force was an initiative of the UK Social Investment Forum in partnership with the New Economics Foundation and the Development Trusts Association, with funding from a number of banks, social investment organisations and charitable foundations. It submitted its report to the Treasury in late 2000. The Chair of the Task Force was Ronald Cohen, head of an equity finance business. Two members were business executives (computing and high street clothing), two were chief executives (a medical trust and a charity), one was a journalist/academic and another a former Vice President of South Shore Bank, a CDFI based in Chicago. There was no one from the regeneration sector.

The Task Force report echoed the approach of PAT 3. It estimated that, even though £3 billion per year was invested in regeneration within the UK's poorest areas, nothing had changed to improve the wealth of residents. Again, enterprise was seen as the solution to the exclusion agenda, arguing that a 'new approach to addressing the needs of under-invested communities would help to rebuild their economic base' (SITF, 2000: 10). Neighbourhood renewal was to be restored by 'local market forces' and this required 'a market-driven system that harnesses entrepreneurial drive' (SITF, 2000: 15). Drawing on the experiences of the community development finance system in the US, the report argued CDFIs were a way of encouraging and enabling financial inclusion in excluded areas. Five policy initiatives were recommended to support the sector: a Community Investment Tax Credit (later Community Investment Tax Relief (CITR)); a Community Development Venture Fund; Bank Disclosure (of their service to poorer communities); a trade association to support CDFIs; and greater latitude for investment in CDFIs.

The SITF report connected favourably with New Labour thinking and at the 2001 national CDFI conference Paul Boateng, as Financial Secretary to the Treasury, stressed New Labour's 'enterprise for all' agenda. Enterprise, rather than benefit offices would revitalise communities. CDFIs would aid entrepreneurs to establish businesses in disadvantaged communities thereby 'creating a new culture of enterprise in Britain, and one that is open to all; building real prospects, and real hope, in some of our most disadvantaged communities; ending social exclusion and opening opportunities that have been closed to many people for too long' (Boateng, 2001). He announced the implementation of the tax credit, which offers tax relief of 5 per cent per annum for a five-year investment in accredited CDFIs. By 2004 22 CDFIs were accredited, ranging from the Charity Bank to Aston Reinvestment Trust. In 2002 the Bridges Community Development Ventures Fund was set up to harness the skills of venture capitalists for regeneration. Made up of £20 million private equity funding and £20 million from the DTI, the fund is not for the small scale. It offers equity finance between £100,000 and £2 million

for companies that guarantee a majority of their staff are from disadvantaged communities.

The community focus on neighbourhood renewal has become a key element of public policy (Taylor, 2003). Savage and Atkinson argue that, for Blair, it became the 'big idea left in politics' (2001: 10). Lying behind the community development finance strategy is the assumption that making financial resources available will trigger untapped sources of entrepreneurship in disadvantaged communities. For James Midgley, an exponent of 'third way' thinking, social development can be achieved by encouraging people to create wealth for themselves (Midgley, 1999). Putting responsibility on communities themselves to seize the initiative and set up commercial and social enterprise reflects the views of Amitai Etzioni that 'people have a moral responsibility to help themselves as best they can' (Etzioni, 1995: 144). Fitzpatrick has described this as an 'ethic of obligation' (2004: 213). The CDFIs aim is to link an economic return with a social return. For the government, the main return is that disadvantaged individuals and communities are encouraged to move from benefits and grants into economic activity.

Social enterprise: linking social objectives and the market

As well as providing finance for private enterprise to aid socio-economic regeneration in deprived communities, CDFIs are a source of loan funding for the social enterprise sector. The CDFA defines social enterprises as 'businesses that trade in the market with a social purpose. They use business tools and techniques to achieve social aims' (CDFA, 2005: 55). Examples cited are co-operatives, development trusts, community enterprises, housing associations, social firms and leisure trusts. The Social Enterprise Unit report *Social Enterprise: A Strategy for Success* defined a social enterprise as 'a business with primarily social objectives whose surpluses are principally reinvested for that purpose in the business or in the community, rather than being driven by the need to maximise profit for shareholders and owners' (DTI, 2002: 7). Labour governments have historically supported the social enterprise sector (Mellor *et al.*, 1988), and New Labour is no exception. The DTI's Social Enterprise Unit was established in 2001, and the government partially funded the Social Enterprise Coalition made up of stakeholders from the banking, CDFI and social enterprise sectors.

Although organisations such as ICOF and Investors in Society/Charity Bank were already lending to social enterprises, New Labour sought to build on these relationships and push more towards the commercial sector. In its review of the sector, the Social Enterprise Unit report found 'many social enterprises are undercapitalised and struggle to access external finance, particularly when starting up, growing or moving away from grant dependency. Ensuring appropriate finance and funding is available to social enterprises is key to enabling the sector to develop and grow' (DTI, 2002: 9). It argued that social enterprises

should be supported as they were 'using business solutions to achieve public good' and 'the Government believes that social enterprises have a distinct and valuable role to play in helping create a strong, sustainable and socially inclusive economy' (DTI, 2002: 7). Tony Blair, in his foreword to the report, highlighted the financial incentive for the government: 'I was struck by the fact that social enterprises are delivering high quality, lower cost products and services' (DTI, 2002: 5).

With the support of community development finance, it is hoped that loan funding will enable social enterprises to become more financially viable and build up a history of credit worthiness that will enable them to borrow from the mainstream. In addition, to make social enterprises more recognisable and acceptable to social investors, the government has suggested a possible new company structure: the Community Interest Company (CIC). It is envisaged that 'CICs should develop to meet the needs of local communities, complementing core Government services in areas such as childcare provision, social housing, leisure and community transport' (DTI, HM Treasury and Home Office, 2003: 3). CICs would ensure that the sector delivers on its public benefit commitment, as there was 'no simple way to guarantee that a not-for-profit distribution company will always work for the public good' (DTI, HM Treasury and Home Office, 2003: 3). Social benefit would be tested, dividends would be capped and assets could only be transferred to another organisation with an asset lock. However, concern has been expressed that the CIC could undermine traditional social enterprise forms, such as the Industrial and Provident Society (Dunn and Riley, 2004).

The commercial potential of social enterprises was somewhat undermined by a Bank of England report in 2003, *The Financing of Social Enterprises*. It found that 'demand for debt finance among social enterprises is limited both by the availability of other, cheaper forms of funding such as grants, and by a cultural aversion to the risks associated with borrowing' (Bank of England, 2003: 1). Social enterprises had skills in writing grant applications, but their business plans lacked financial awareness and 'financial expertise among social enterprises was weak' (Bank of England, 2003: 40). Nevertheless, new specialist lenders such as the CDFIs were seen as being innovative and less prescriptive than the formal banking sector. At the 2003 CDFI annual conference, delegates expressed the feeling that recognition by the Bank of England brought the CDFI and social enterprise sectors closer to mainstream acceptance, although additional work was necessary to connect up the requirements of lenders (banks and CDFIs) with the needs of social enterprises. Further evidence of mainstreaming social enterprise was the 2004 publication of the Small Business Service's *Lending to the Social Enterprise Sector* (SBS, 2004). The market approach to social enterprise was also heralded by the title of a series of seminars, *Social Enterprise: Making the Market*, held by the Social Enterprise Unit (DTI, 2003). Earlier, in the PAT 3

report *Enterprise and Social Exclusion*, it was suggested that responsibility for the sector should lie with the Small Business Service and social enterprises 'should be served like other enterprises' (HM Treasury, 1999: 117).

Community enterprises that were unable to raise sufficient finance to deliver their projects effectively could be supported by the Adventure Capital Fund. Launched by the Home Office in 2002, the £4 million fund provides 'social venture capital' through long-term loans or, where appropriate, equity investment. At least one author has expressed concern that the government approach to social enterprises may undermine the traditional governance forms of social enterprise by allowing for the possibility of equity investment for profit (Brown, 2002). Social and community enterprises are also being seen as able to supplement, or even replace, services in disadvantaged communities traditionally supplied by the public sector. This reflects the third approach to regeneration: the encouragement of the community and voluntary sector to move towards a more enterprise-based financial approach, particularly through loan funding.

From grants to loans: changing the face of welfare and charity

The link between community development finance and the voluntary sector takes two forms. One is the move towards asking community and voluntary organisations to take loans rather than grants. The other is a move from grants to loans within charitable institutions. One of the Social Investment Task Force's recommendations, implemented in May 2001, was a change in regulations to allow charitable trusts to lend money. The report argued that programme-related investments (loans) would provide 'greater latitude and encouragement for charitable trusts and foundations to invest in community development initiatives' (SITF, 2000: 6). The report recognised that loan investments for trading purposes, with the possibility of private gain, might put charitable status in question, but 'the key consideration is the balance between the public and the private benefits flowing from the regeneration initiative. For the initiative to be charitable, any private benefits it generates must be outweighed by the wider public benefit' (SITF, 2000: 22). Loans to purely commercial enterprises, such as micro businesses, could be justified if they were within areas of financial exclusion.

In the US, which has provided much of the inspiration for UK CDFI development, charitable lending provided 22 per cent of CDFI loan capital in 1999 (SITF, 2000). In the UK, the Northern Rock and Esmée Fairbairn Foundations have already set aside funds for loan distribution through the Charity Bank. The new approach is seen as encouraging socially oriented organisations to be more financially aware, while also allowing money to be recycled through re-lending. As a representative of the Northern Rock Foundation speaking at a conference stated, it 'would give more bangs per buck' (*Breaking the Barriers*, 2004). Both PAT 3 and the SITF report questioned grant funding for social enterprise, community

activities and the wider voluntary sector. For PAT 3, 'the public and voluntary sectors are too stuck in a culture of grants; we should have a presumption in favour of loans wherever there are positive financial returns' (HM Treasury, 1999: 4). It argued that loans were a more efficient use of finite public funds, and therefore grant funding needed to be kept to 'judicious use' (HM Treasury, 1999: 115). The SITF report also targeted the 'grant culture' calling for 'a major cultural shift from the public, charitable, voluntary and community sectors towards a more entrepreneurial approach' (SITF, 2000: 10). The case for the commercial potential of the voluntary sector was drawn from Scottish research that showed contracted-out public services made up 38 per cent of the charitable sector's income (SITF, 2000).

However, encouraging the voluntary sector to move from grants to loans represents a major change in social policy, particularly when this is accompanied by a push towards privatising the public sector (Land, 2004).

Futurebuilders: capitalising the voluntary sector

At the 2003 National Council for Voluntary Organisations annual conference, the government's neo-market approach to the voluntary sector was clearly signalled by Blairite moderniser Alan Milburn's advocacy of 'voluntary finance initiatives' to bring loan finance to the voluntary sector (*The Guardian*, 10 December 2003). This policy direction is reflected in a recent policy initiative, Futurebuilders.

Set up in 2004, Futurebuilders is a publicly financed investment fund worth £125 million that explicitly seeks to expand the capacity of the not-for-profit sector to meet public service needs. Its stated aim is to 'increase the role that the voluntary and community sector plays in the delivery of public services' (Futurebuilders, 2004a) and 'improve public service delivery through long-term investment in the voluntary and community sector in England' (Futurebuilders, 2004b: 4). Initially, the three-year project will invest £100 million in loans and give £25 million development grants to around 250 organisations in five specific areas: community cohesion; crime; education and learning; health and social care; and support for children and young people. It estimated that it will make four loans of £10 million, four loans at £3 million and another 20 at £1 million and still have sufficient funds available for many smaller loans (Futurebuilders, 2004c). Futurebuilders itself aims to achieve sustainability through interest repayments on its loan fund that will be administered through existing CDFIs.

The market thrust is made clear. The voluntary sector is to be pushed towards 'less dependency on short-term grants and more emphasis on earning income' (Futurebuilders, 2004b: 4). Publicly funded grants and loans are seen more as investments in future self-funding capacity, rather than as public provision to meet immediate social need. The problem of marginality and social and financial exclusion will be dealt with by Futurebuilders being willing to 'share risk and

work with the investees to manage risk in the most effective way possible' (Futurebuilders, 2004b: 14). For the government, a more financially driven approach will help the voluntary sector 'become more effective and efficient' and thereby enable it 'to become a more active partner with Government in shaping policy and delivery', particularly in 'revitalising communities' (Cabinet Office, 2002: 7).

The Treasury has argued that voluntary and community organisations 'are often uniquely placed to reach marginalised groups and enable individuals to participate actively in their local communities' (HM Treasury, 2002: 5). Tony Blair has argued that, by 'combining strong public service ethos with business acumen, we can open up the possibility of entrepreneurial organisations – highly responsive to customers and with the freedom of the private sector – but which are driven by a commitment to public benefit rather than purely maximising profits for shareholders' (DTI, 2002: 5). Such statements are used as a justification for increasingly looking to the sector as an alternative public service provider replacing "monopoly providers" of public services by efficient suppliers, disciplined by the competitive realities of the market' (Clarke, 2004: 31). The aim of moving away from grant-based expenditure and towards a social enterprise approach reflects the government's search for the elusive 'third way' that combines private and public approaches to social welfare (Dean, 2003; Wetherly, 2001; Powell, 2000; Painter, 1999).

The arguments from the proponents of new economics are that a loan-based system would be more flexible, less bureaucratised and more responsive at the community level (Mayo and Moore, 2001; Simms *et al.*, 2002). Finance could be used in new ways, particularly to build an asset base, allowing greater flexibility and responsiveness to users. Some attendees from the voluntary sector at a conference in Newcastle on Social Investment in June 2003 acknowledged that loans might be more flexible than grants, but in general there was very strong resistance to the move in informal workshops on the topic (Affleck and Mellor, 2003). Others have expressed a deep mistrust of the whole thrust of New Labour's welfare reforms towards encouraging public services into the private sector and/or self-organising community-based delivery (Harris, 2002). While a more entrepreneurial community or voluntary sector might provide a better service, there is a suspicion that the push towards the market may mask insufficient public funding.

Community development finance: a sustainable approach to regeneration?

CDFIs emerged to meet the investment needs of the social enterprise sector and to provide small-scale loans for those who were socially excluded from mainstream financial services. In the process they aim to 'create social change through the

impact of the finance and the services they offer' (CDFA, 2005: 5). The nature of this change is not entirely clear. There is an assumption in some writings that revitalising communities is an end in itself. To boost local economic renewal is to build thriving communities (NEF, 2004: 18). Whether those local economies will be essentially different from the wider market economy that has failed them is not clear. There are certainly benefits in the growth of CDFIs. They provide patient finance and a source of investment to financially excluded groups and individuals. CDFI investment is more flexible than seeking public funding for projects or waiting to attract the attention of charities, private companies or banks. CDFIs are also a means of transferring financial resources from social investors, those who put social benefit above financial return in their choice of investment, to financially excluded communities (Affleck and Mellor, 2003, 2005).

Our research, which explored the experience of CDFIs in the North East, together with some national examples, found some problems in building a client base (Affleck and Mellor, 2003). As the Chief Executive of one organisation said, a critical issue was 'Referrals, Referrals, Referrals'. This could be because there were no untapped entrepreneurs within disadvantaged communities or community organisations wanting to take on loans. On the other hand, the problem could be communications and the problem of developing an efficient delivery mechanism (Affleck and Mellor, 2003). CDFIs are generally small organisations with an average of seven staff. The people they seek to serve are socially marginalised. It would not be surprising if they found it difficult to link up with each other. One of the outcomes of our research was a booklet that we distributed in the Tyneside area, listing the various community development agencies and lenders (Sustainable Cities Research Institute, 2003).

There is evidence of surplus capacity in the CDFI sector at present. Of £400 million capital, only £147 million is out on loan (CDFA, 2005: 3). Deployment rates average 49 per cent, but the spread ranges from 10 per cent to 100 per cent (CDFA, 2005: 44). The CDFA sees this as a function of the development stage of many CDFIs and the sector in which they operate (micro-credit, social enterprise or personal loans). In a survey of its members, the CDFA found that 'volume of deal flow' was the second most important issue raised; the problem of finding revenue funding was the first (2005: 50). In 2004 Street UK, a micro-credit agency, closed its London office citing over-capacity in the capital. The particular problems for micro finance were recognised in the PAT 3 *Enterprise and Social Exclusion* report. It noted that, despite 'heroic examples of success', the sector was still 'masked in a difficult and fraught process of institutional development' (HM Treasury, 1999: 66). While there has been evidence of highly successful micro-finance initiatives, particularly in Bangladesh where it originated, countries have experienced very different success rates (Honohan, 2004).

A problem for CDFIs that aim to support the most financially excluded is their own viability. As one CDFI loan manager pointed out, if there were profits available in this lending the commercial banks would already be doing it. Also, as the major costs for CDFIs are administration and development support, the more a CDFI works with the potential borrower to improve their business idea and make it viable, the more they increase their own costs. The Phoenix Fund has contributed substantially to CDFI revenue funding to date, but this ceases in 2008. In the 2004 round of Phoenix bidding, CDFIs were asked to bid 'in order that they can themselves address market failures in financial services provision for enterprise' (SBS, 2003: 2). This is a major demand to place on what is still a small and new sector, particularly as the government's aims would seem to preclude viability. If the role of CDFIs is to progress financially excluded enterprises and individuals through to the conventional banking system, CDFIs must inevitably lose their most viable, and therefore most valuable, clients.

The sector may also suffer through the government's decision to shift responsibility for CDFIs to the regional development agencies. The CDFA has called for the national fund to be reinstated (West and Palmer, 2004; Hayday, 2004). The Chief Executive of the CDFA, Bernie Morgan, has argued that the proposal 'though sound in theory, has several weaknesses: it doesn't address the needs of CDFIs that operate in more than one region; and it depends on the engagement of RDAs (which is variable) and leaves the sector exposed to changes in RDA policy' (Morgan, 2004: 27). The plans to merge the DTI's Social Enterprise Unit with the Small Business Service can also be seen as a downgrading of the sector and might affect protection of its social aspect. It also makes an assumption that social enterprises are small, which is not true of many industrial and provident societies.

A danger for the CDFI sector is that it becomes absorbed into a wider government agenda with regard to the voluntary sector and the future delivery of public services. CDFIs could then be seen as undermining public services or the charitable and voluntary sector by encouraging neo-market activities. On the other hand, the voluntary sector may be more effective if it can borrow money against future grants or donations. One of the arguments for the 'new economics' is that it is more grassroots and bottom up. Many of the CDFIs are themselves social enterprises. Very few, however, are social enterprises in the sense of being socially owned by members or users. As the CDFA survey showed, most have managerial boards and Chief Executives (CDFA, 2005: 47). It is questionable, therefore, how far local communities see the CDFI lenders as markedly different to the government, banks or other agencies. There are some co-operative organisations that engage in CDFI activities, such as the Irish Credit Unions which support local enterprise (McCarthy *et al.*, 2000), although beneficiaries are expected to be members of, or join, the credit union.

Conclusion

The CDFI sector aims to aid regeneration by bridging a perceived 'gap' in enterprise finance for poorer communities. It also aims to build the social enterprise sector through loan finance. Through these activities CDFIs aim to create social change, although the nature of this change is ill-defined. The CDFI approach has chimed with the third way thrust of New Labour by looking 'for higher social returns than traditional private investment and higher financial returns than traditional public expenditure and grants' (SITE, 2000: 15).

The CDFIs and government regeneration policies place a lot of faith in the potential economic vitality of local communities. It is not clear, however, how encouraging enterprise and self-help will build vibrant communities. As Driver and Martell argue, New Labour's 'third way' appears to want to square the circle by aiming to 'promote wealth creation *and* social justice, the market *and* the community; that will embrace private enterprise but not automatically favour market solutions' (2002: 70). The neo-market approach reflects what Taylor sees as the search for 'a political vocabulary which eschews market individualism, but not capitalism; which embraces collective action, but not class or the state' (Taylor, 2003: 40). The aim appears to be to harness the market for social policy ends (Leibfried and Pierson, 2000) yet, as Williams and Clarke argue, the efficacy of market forces has been much overstated (Clarke, 2004; Williams, 2004). Arguably, the focus should be on the failure of mainstream financial organisations to invest in poorer communities (Hutchinson *et al.*, 2002), something that has been recognised in a number of government reports (HM Treasury and SBS, 2002; SBS, 2004).

The promotion of community and social enterprise through supplying loan funding to the community and voluntary sectors is also potentially contentious. Any radical intentions the CDFIs have may be undermined if they are seen as the agent of a more market-oriented government regeneration agenda. One of the critical problems is the viability of the CDFIs themselves. It remains to be seen whether they can build into a viable sector that is an alternative to the market rather than merely a bridge to it.

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